

## Message Text

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C O N F I D E N T I A L SECTION 1 OF 3 SECTIONS USNATO 5196

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SUBJECT: CENTRAL EUROPE PIPELINE SYSTEM (CEPS) COST SHARING FORMULA

REF: USNATO 5139

IN ACCORDANCE WITH DECISION AT SEPTEMBER'S CENTRAL EUROPE  
PIPELINE POLICY COMMITTEE (CEPPC) MEETING (REPORTED REFTL),  
CHAIRMAN HAS CIRCULATED ADVANCE COPY OF HIS REPORT TO AMBASSADORS  
AS QUOTED BELOW. EXPECT OFFICIAL TRANSMISSION OF DOCUMENT  
DURING WEEK OF 30 SEPTEMBER OFR PERM REP MEETING IN WEEK OF 7  
OCTOBER.

BEGIN TEXT:

AC/120-D/875

SEPTEMBER 24, 1974

CENTRAL EUROPE PIPELINE POLICY COMMITTEE  
REPORT TO AMBASSADORS ON THE DEVELOPMENT  
OF A NEW COST-SHARING FORMULA FOR THE  
CENTRAL EUROPE PIPELINE SYSTEM

MEMORANDUM BY THE ACTING CHAIRMAN

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THE CENTRAL EUROPE PIPELINE POLICY COMMITTEE IN  
AMBASSADORIAL SESSION IS REQUESTED URGENTLY TO ESTABLISH A  
NEW COST-SHARING FORMULA FOR THE CALL UP OF CONTRIBUTIONS FROM  
THE PARTICIPATING COUNTRIES TO COVER THE ANNUAL BUDGETARY

SHORTFALL RESULTING FROM THE OPERATING OF THE CENTRAL EUROPE PIPELINE SYSTEM.

#### BACKGROUND CONSIDERATIONS

2. ALTHOUGH THE CENTRAL EUROPE PIPELINE SYSTEM DRIVES SUBSTANTIAL REVENUE FROM THE TARIFFS IT CHARGES THE MILITARY AND CIVIL USERS, THE REVENUE HAS NEVER BEEN ENOUGH TO MEET THE OPERATING COSTS. THESE COSTS ARE HIGH BY COMMERCIAL PIPELINE STANDARDS, THE PRINCIPAL REASON BEING THAT THE SYSTEM WAS DESIGNED AND BUILT TO MEET A WARTIME MILITARY REQUIREMENT AND ITS CAPACITY EXCEEDS THE PEACE-TIME MILITARY DEMANDS UPON IT, WITH THE RESULT THAT THERE IS UNDER-UTILIZATION OF LARGE PARTS OF THE SYSTEM. THIS, IN TURN, HAS NOT JUSTIFIED LARGE CAPITAL OUTLAYS TO IMPROVE OPERATING EFFICIENCY BY EXTENSIVE MECHANIZATION. THE COSTS OF UNDER-UTILIZATION HAVE BEEN MITIGATED IN AREAS WHERE THE PIPELINE COMES CLOSE TO IMPORTANT POPULATION CENTRES BY MAKING THE SYSTEM AVAILABLE TO CIVIL USERS, BUT THE GEOGRAPHIC ROUTING OF THE PIPELINE GREATLY LIMITS THE AMOUNT OF RELIEF BY THIS MEANS. AS A CONSEQUENCE, THE CEPS IS NOT CAPABLE OF BEING WIDELY COMPETITIVE WITH OTHER MEANS OF TRANSPORT OF PETROLEUM PRODUCTS. IT HAS ALSO BEEN GENERAL POLICY TO ESTABLISH THE SYSTEM'S TARIFFS AT A LEVEL THAT WOULD NOT UNDULY COMPETE WITH AND AFFECT ADVERSELY THE CAPACITY OF THE OTHER MEANS OF TRANSPORT TO RESPOND TO A CRISIS SITUATION. FINALLY, THERE IS NO COMPULSION ON ITS USERS, MILITARY OR CIVIL, TO USE THE SYSTEM UNLESS IT IS ADVANTAGEOUS TO DO SO. THE SHORTFALL BETWEEN OPERATING COSTS AND REVENUE HAS BEEN COVERED BY PERIODIC CALLS FOR CONTRIBUTIONS FROM PARTICIPATING COUNTRIES ESTABLISHED BY MEANS OF A COST-SHARING FORMULA.

3. SINCE THERE WAS NO EXPERIENCE AT THE TIME, THE COST-SHARING FORMULA TAKEN INTO USE AT THE BEGINNING OF OPERATIONS OF THE CEPS IN 1957 WAS AN AD HOC ARRANGEMENT PREDICATED ON THE EXPECTED LEVEL OF USE OF

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THE SYSTEM BY THE PARTICIPATING COUNTRIES.

4. A NEW FORMULA WAS AGREED IN 1964. THE BASIS OF DEVELOPING THIS FORMULA WAS THE AVERAGE CURRENT PEACE-TIME AND FORESEEN WAR-TIME MILITARY USE OF THE SYSTEM BY THE COUNTRIES. HOWEVER, THE FORMULA AS FINALLY AGREED WAS A COMPROMISE THAT GIVE SOME COUNTRIES A COST SHARE LESS AND OTHERS A COST SHARE GREATER THAN THEIR CALCULATED MILITARY USE. THE FORMULA, STILL IN FORCE, IS SHOWN IN THE FIRST COLUMN OF THE TABLE UNDER PARA 11.

5. OVER THE YEARS IT CAME TO BE RECOGNIZED THAT CERTAIN NATIONAL POLICIES PURSUED BY INDIVIDUAL HOST COUNTRIES (BELGIUM, FRANCE, GERMANY AND THE NETHERLANDS) IN OPERATING

THE NATIONAL DIVISIONS OF THE SYSTEM GAVE AN ECONOMIC ADVANTAGE TO ONE COUNTRY NOT ENJOYED BY THE OTHER COUNTRIES OR IMPOSED ON THE CEPS BUDGET AN EXTRA COST NOT INCURRED IN OPERATING A DIVISION IN ANOTHER HOST COUNTRY. EFFORTS OF THE CEPPC TO ELIMINATE OR MITIGATE WHAT WERE CONSIDERED TO BE DISCRIMINATORY FEATURES IN THE FINANCING OF THE SYSTEM WERE LARGELY ABORTIVE BECAUSE THE SOLUTIONS PROPOSED USUALLY IMPINGED ON THE PREROGATIVES OF THE NATIONS LAID DOWN IN THE CEPS CHARTER TO PARTICIPATE IN THE MANAGEMENT OF THE CEPS. THE CHRONIC PROBLEM THEREFORE BECAME CONSTANT IRRITANTS IN THE DEVELOPMENT AND EXECUTION OF POLICY FOR THE CEPS. CIVIL USE ADDED OTHER IRRITANTS EVEN THOUGH IT REDUCED THE SIZE OF THE BUDGETARY SHORTFALL.

6. AS A CONSEQUENCE, THE UNITED STATES IN PARTICULAR STARTED TO ARGUE SEVERAL YEARS AGO THAT IT WAS BEING ASKED TO ACCEPT, THROUGH THE BUDGETARY SHORTFALL, A LARGER CONTRIBUTION THAN WOULD BE WARRANTED IF A CENTRALLY DETERMINED AND CONSISTENTLY APPLIED MANAGEMENT POLICY WAS BEING PURSUED, AND THAT, SINCE IT DID NOT HAVE A VOICE IN THE DAY-TO-DAY MANAGEMENT OF THE DIVISIONS OF THE SYSTEM, IT SHOULD HAVE A COST SHARE LOWER THAN WOULD BE ESTABLISHED BY ITS MILITARY USE OF THE SYSTEM. THIS POSITION WAS RE-EMPHASIZED IN THE UNITED STATES INITIATIVE ON BURDEN SHARING.

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BASIS FOR A NEW COST-SHARING FORMULA

7. THE CEPPC STARTED TO GIVE SERIOUS CONSIDERATION TO THE DEVELOPMENT OF A NEW COST-SHARING FORMULA ABOUT A YEAR AGO.

8. ITS FIRST APPROACH WAS TO ATTEMPT TO RESOLVE THE CHRONIC PROBLEMS SO AS TO GIVE A FIRMER AND MORE SATISFACTORY BASE FOR DEVELOPING A COST-SHARING FORMULA BASED ON THE CURRENT MILITARY USE OF THE CEPS. HOWEVER, THE CHRONIC PROBLEMS CONTINUED TO BE UNRESOLVABLE IN ANY FORESEEABLE SHORT PERIOD OF TIME.

9. IT WAS THEN SUGGESTED AND GENERALLY ACCEPTED AS A METHOD OF APPROACH THAT A FORMULA SHOULD BE DEVELOPED THAT WOULD SUBSUME THE RECOGNIZED CHRONIC PROBLEMS. MORE SPECIFICALLY, THE COST SHARES OF THE HOST COUNTRIES BASED ON CURRENT MILITARY USE WOULD BE AUGMENTED IN SOME WAY TO TAKE ACCOUNT OF THE CHRONIC PROBLEMS, WHICH WOULD THEN BE CONSIDERED AS SOLVED. THE AUGMENTATION OF THE COST SHARES OF THE HOST COUNTRIES WOULD BE OFFSET BY A REDUCTION OF THE COST SHARES BASED ON MILITARY USE OF THE NON-HOST COUNTRIES (CANADA, LUXEMBOURG, THE UNITED KINGDOM AND THE CONFIDENTIAL

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UNITED STATES). IT WAS ALSO HOPED THAT THE AUGMENTED COST SHARES OF THE HOST COUNTRIES WOULD BE AN INCENTIVE TO THEM TO FIND WAYS OF REDUCING THE OPERATING COSTS OF THE SYSTEM.

10. IT WAS RECOGNIZED FROM THE START THAT THE CHRONIC PROBLEMS COULDN NOTBE EFFECTIVELY COSTED, AND THAT THEREFORE THE AUGMENTATION OF THE COST SHARES OF THE HOST COUNTRIES WOULD HAVE TO BE ARRIVED AT BY SUBJECTIVE JUDGMENT.

11. AT THE REQUEST OF THE CEPPC, THE GENERAL MANAGER OF THE CEOA WORKED OUT SIX FORMULAE BASED ON PAECE, WAR AND COMBINED PEACE AND WAR MILITARY USE OF THE SYSTEM, THE AVERAGE OF WHICH WAS GENERALLY ACCEPTED AS REPRESENTING THE CURRENT USE OF THE SYSTEM BY THE PARTICIPATING COUNTRIES. USING THE AVERAGE FORMULA AS A POINT OF DEPUARTURE NOT LESS THAN SIX FORMULAE WERE OFFERED FOR CONSIDERATION AS MEETING THE OBJECTIVE SET FORTH IN PARA 9. IN ADDITION, THERE WAS A PROPOSAL THAT THE HOST COUNTRIES SHOULD ASSUME DIRECTLY A PERCENTAGE OF THE COST OF THE BUDGET OF THEIR DIVISIONS(S), WITH THE RESULTING REDUCED BUDGETARY SHORTFALL COST SHARED AMONG COUNTRIES ON THE BASIS OF MILITARY USE. AFTER CONSIDERING THE MERITS OF EACH PROPOSAL, A CONSENSUS DEVELOPED IN FAVOUR OF SUBMITTING TO COUNTRIES FOR CONSIDERATION ONE OF THE FORMULAE THAT LACKED THE EXTREMES OF COST SHARES FOUND IN THE OTHER FORMULAE. THIS FORMULA IS SHOWN IN THE THIRD COLUMN OF THE TABLE HEREUNDER, AND FOR COMPARATIVE PURPOSES THE COST-SHARING FORMULA IN USE SINCE 1964 AND THE AVERAGE CURRENT MILITARY USE FORMULA DEVELOPED BY CEOA ARE INCLUDED.

CURRENT	AVERAGE	SUGGESTED
COST-SHARING	MILITARY USE	NEW COST-

	FORMULA	FORMULA	SHARING FORMULA
UNITED STATES	36.07	37.280	24
FRANCE	16.00	18.332	24
GERMANY	16.00	22.792	24
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BELGIUM	9.70	7.175	9
NETHERLANDS	9.70	5.807	9
UNITED KINGDOM	9.73	57.521	8
CANADA	2.77	1.091	2
LUXEMBOURG	0.03		
TOTAL	100.00	100.000	100

## CURRENT POSITIONS ON COST SHARING

12 A FACTOR THAT HAS IMPEDED NEGOTIATING OF A NEW COST-SHARING FORMULA HAS BEEN UNCERTAINTY AS TO WHETHER THE NEGOTIATIONS WERE BEING CARRIED OUT UNDER THE NATO-WIDE BURDEN-SHARING EXERCISE OR UNDER THE AEGIS OF THE CEPPC. OF RECENT DATE, IT HAS BEEN AGREED THAT THE ESTABLISHING OF A NEW COST-SHARING FORMULA IS A CEPPC INITIATIVE.

13. THE POSITIONS OF THE PARTICIPATING COUNTRIES TOWARD ACCEPTANCE OF THE PROPOSED NEW COST-SHARING FORMULA GIVEN UNDER PARA 11 ARE AS FOLLOWS:

(A) BELGIUM, CANADA, LUXEMBOURG, THE NETHERLANDS AND THE UNITED KINGDOM CAN ACCEPT THE COST-SHARING FORMULA AND THEIR RESPECTIVE SHARES THEREIN.

(B) THE UNITED STATES CAN ACCEPT THE COST SHARE PROPOSED FOR IT OF 24 PER CENT IF OTHER PARTICIPATING COUNTRIES CAN ALSO ACCEPT 24 PER CENT AS THE USA COST SHARE. FROM SUB-PARA (A), IT CAN BE CONCLUDED THAT FIVE COUNTRIES CAN SO ACCEPT, SO THE ACCEPTANCE OF TWO COUNTRIES - FRANCE AND GERMANY - ARE OUTSTANDING.

(C) GERMANY HAS AGREED TO THE NEGOTIATING OF A NEW COST-SHARING FORMULA, BUT HAS NOT YET REACHED CONCLUSIONS ON WHAT THE FORMULA SHOULD BE, AND  
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PARTICULARLY WHAT THE GERMAN SHARE SHOULD BE.

(D) FRANCE HAS AGREED TO THE NEGOTATING OF A NEW COST-SHARING FORMULA BUT SAYS THAT IT IS STILL CONSIDERING THE SUGGESTED NEW COST-SHARING FORMULA AND OTHER FORMULAE THAT HAVE BEEN PRESENTED, AND THAT IT CANNOT AS YET ADOPT A POSITION ON COST SHARING.

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14. THE EFFECTIVE DATE OF IMPLEMENTATION OF A NEW COST-SHARING FORMULA IS STILL UNRESOLVED. THE MATTER HAS NOT BEEN THOROUGHLY EXPLORED BY CEPPC BECAUSE IT IS RECOGNIZED THAT THE ESTABLISHMENT OF THE NEW FORMULA COMMANDS PRIORITY ATTENTION. DATES OF 1 JANUARY 1974, 1 JANUARY 1975 AND DATES IN BETWEEN, SUCH AS DATE OF ACCEPTANCE OF A NEW COST-SHARING FORMULA OR THE MID-YEAR POINT OF 1 JULY 1975, HAVE BEEN MENTIONED. SINCE THE MAJORITY OF THE COMMITTEE APPEAR TO BE FLEXIBLE, THE CEPPC COULD PROBABLY RESOLVE THE MATTER UNLESS A COUNTRY MAKES THE EFFECTIVE DATE A CONDITION PRECEDENT TO ACCEPTING A NEW COST-SHARING FORMULA, IN WHICH CASE IT WILL HAVE TO BE TAKEN IN HAND BY THE AMBASSADORS.

FINANCIAL SITUATION OF CEOA

15. LATE IN 1973, THE UNITED STATES INFORMED THE OTHER PARTICIPATING COUNTRIES OF THE CEPS THAT IT WAS NOT PREPARED TO PAY ITS 1974 CONTRIBUTIONS (36.07 PER CENT OF THE TOTAL CONTRIBUTIONS UNDER THE FORMULA IN FORCE) UNTIL A NEW COST-SHARING FORMULA WAS ACCEPTED. AT MID-

YEAR 1974, WHEN THE FINANCIAL LIQUIDITY OF CEOA WAS BEING SERIOUSLY THREATENED BY THIS POSITION, THE UNITED STATES  
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AGREED TO PAY 12 PER CENT (APPROXIMATELY ONE-THIRD OF ITS SHARE) OF THE CALLS MADE OR TO BE MADE ON IT DURING FISCAL YEAR 1974.

16. AT THAT TIME, OTHER PARTICIPATING COUNTRIES ADOPTED POSITIONS THE EFFECT OF WHICH CLOSED OFF THE POSSIBILITIES OF CEOA TEMPORARILY OBTAINING FUNDS TO COVER THE 24 PER CENT CONTRIBUTION GAP CONTINUING TO EXIST AS A RESULT OF THE NEW POSITION TAKEN BY THE UNITED STATES.

17. AFTER ASSESSING THE SITUATION, THE GENERAL MANAGER OF CEOA INFORMED THE CEPPC THAT CEOA WOULD ONLY BE ABLE TO PRE-FINANCE THE NATIONAL DIVISIONS, ETC., UNTIL THE MONTH OF COTOBER 1974 INCLUSIVE, AND THAT IF THE FINANCIAL CONSTRAINTS PLACE ON CEOA WERE NOT BY THAT TIME RELAXED, THE HOST NATIONS WOULD HAVE TO BE ASKED TO TAKE ADMINISTRATIVE AND FINANCIAL RESPONSIBILITIES FOR THEIR SEGMENTS OF THE PIPELINE, AND HE WOULD HAVE TO INITIATE ACTION LOOKING TO THE DISSOLUTION OF CEOA. THE MILITARY IMPLICATIONS OF SUCH A COURSE OF ACTION HAVE BEEN CONSIDERED BY SACEUR AND CINCENT AND THE CHAIRMAN OF THE MILITARY COMMITTEE HAS WRITTEN TO THE SECRETARY GENERAL THEREON.

18. A RE-ASSESSMENT OF THE FINANCIAL SITUATION AT THE LAST MEETING OF THE CEPPC ON 19-20 SEPTEMBER SHOWED THAT THE POSITIONS ADOPTED BY THE PARTICIPATING COUNTRIES AT MID-YEAR (PARAS 15-16) HAD NOT CHANGED. HOWEVER, THE UNITED STATES ADI THAT IF ITS POISITION ONCOST SHARING SET OUT INPARA 13(B) WAS ACCEPTED BY ALL PARTICIPATING COUNTRIES, IT WOULD IMMEDIATELY BRING ITS CONTRIBUTIONS UP TO THE 24 PER CENT LEVEL. THIS WOULD HAVE THE EFFECT OF EXTENDING THE CRITICAL DATE SOMEWHAT BEYOND 31 OCTOBER. HOWEVER, CEOA IS FACING FINANCIAL STRINGENCY FROM ANOTHER DIRECTION. RISING OPERATING COSTS AND FALLING REVENUE RESULTING FROM THE OIL CRISIS ARE INCREASING THE SIZE OF THE 1974 BUDGETARY SHORTFALL AND IT WILL BE NECESSARY FOR THE GENERAL MANAGER OF CEOA TO ASK PERMISSION TO MAKE A THIRD 1974 CALL FOR CONTRIBUTIONS AT THE OCTOBER MEETING OF THE CEPPC.  
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#### CONCLUSIONS AND RECOMMENDATIONS

19. HAVING REGARD FOR THE PRECARIOUS FINANCIAL

POSITION OF CEOA, THE CEPPC, AT ITS LAST MEETING,  
CONCLUDED THAT IT WAS NOT IN A POSITION TO OBTAIN  
AGREEMENT ON A NEW COST-SHARING FORMULA IN THE TIME  
AVAILABLE TO IT, AND ACCORDINGLY THE AMBASSADORS OF THE  
CEPS ARE BEING REQUESTED, ON AN URGENT BASIS, TO DEAL  
WITH THE FOLLOWING MATTERS AS REQUIRED:

(A) ESTABLISH A NEW COST-SHARING FORMULA FOR THE CENTRAL  
EUROPE PIPELINE SYSTEM.

(B) ESTABLISH THE EFFECTIVE DATE OF APPLICATION OF THE  
NEW FORMULA IF THE DATE OF APPLICATION IS A  
CONDITION PRECEDENT TO THE ACCEPTANCE OF A NEW  
FORMULA.

(C) IF UNDUE DELAY IS ENCOUNTERED IN ARRIVING AT  
DECISIONS ON (A) AND (B) ABOVE, TO CONSIDER WHAT  
MEANS CAN BE FOUND TO CONTINUE TO FUND THE BUDGETARY  
SHORTFALL OF THE SYSTEM UNTIL THESE DECISIONS ARE  
TAKEN.

20. ATTENTION IS DRAWN TO THE FACT THAT IN THE  
PROPOSED NEW COST-SHARING FORMULA FOUND IN THE TABLE  
UNDER PARA 11 NO PROVISION HAS BEEN MADE FOR A COST SHARE  
FOR LUXEMBOURG. THIS HAS NOT BEEN AN OVERSIGHT BY CEPPC  
BUT A RECOGNITION THAT, SINCE LUXEMBOURG IS ONLY MARGINAL  
INVOLVED IN THE OPERATION OF THE CEPS, ITS COST SHARE  
SHOULD BE NOMINAL AND THEREFORE EASY TO INCLUDE IN A NEW  
COST-SHARING FORMULA. AMBASSADORS ARE REQUESTED TO MAKE  
THIS INCLUSION.

(A.S. DUNCAN),

ACTING CHAIRMAN.

END TEXT.  
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